

INFLUENCE PRIVATIZATION ON IMPROVEMENT OF EFFECTIVENESS OF PRIVATIZED PUBLIC BANKS IN IRAN?

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ABSTRACT

Increase of effectiveness is one of the aims of privatization. In Iran also, privatization of governmental enterprises to the aim of effectiveness has gained huge concern from the system soon after notification of general policies of the Principle 44 of the Constitution.

To answer the question that has Privatization influence on Improvement of Effectiveness of Privatized public banks? Following a SFA approach, a number of Privatized public banks after and before Privatization, were measured in terms of their effectiveness. The findings show that the effectiveness of the whole range of the Privatized public, compared to that when they were part of public sphere, was less effective. Therefore, no direct cause effect relationship between privatization and effectiveness. Thus, the only alternative to making the public enterprises effective is not made possible by the privatization of these businesses.

KEYWORDS: Bank, Effectiveness, Privatization

INTRODUCTION

The literature on the impact of privatization on the financial and operating performance of firms is extensive and thoroughly reviewed by Megginson and Netter (2001) and Djankov and Murrell (2002). Most empirical studies document enhanced post privatization performance by newly privatized firms. Such evidence is provided for firms in developed and developing countries, as well as in transition economies. But on the effects of privatization on the effectiveness of the study have not been found. Privatization has been instrumental in reducing state ownership in many countries and many sectors. A closer look at the privatization experience across countries and industries suggests that there exist considerable differences in the way privatization is implemented. Most developing countries launched their privatizations focusing primarily on competitive firms rather than strategic sectors such as utilities, telecommunications and banking. Since late 1970, privatization has become a dominant aim in national policies of the governments and each country has pursued a certain model of privatization according to its own condition. Undoubtedly, privatization is defined as delegating role and function of governmental sector to private sector through assigning enterprise's ownership and management to the latter. Privatization is a method of enhancement of effectiveness in goods and services' production process as well as revenue increase in enterprises. This way, economic performance and effectiveness improvement realizes through creating an incentive system based on personal benefit. Generally Economic reforms, financial development, financial integration, privatization, liberalization and consolidation among other trends have characterized these economies since the late 1980s.

Investors seeking higher rates of growth or diversification were encouraged to enter emerging markets to capitalize on the abundant opportunities available. Banking sectors in emerging economies often play a vital role in the success or failure of such initiatives. Thus, they attract ample attention, especially because of the rich and complex environment brought on by dynamic and rapid changes in bank ownership.

Point of departure of privatization policy in Iran has its roots in the First Development Plan, after 1979 Revolution. Banking and insurance industries, health and treatment as well as education sectors are considered as those points of focus gradually covered by privatization policy, after the war. During recent years, implementation of general policies of the 44th Principle of the Constitution has refreshed Iranian financial markets and economic scene. Three decades passed from commencement of privatization in the world, it has begun seriously in Iran upon notification of general policies of the Principle 44 of the Constitution, and in consideration of new Rules and statutory policies including The Future Outlook of the Islamic Republic of Iran in the Horizon of the Next Two Decades, in addition to the Law on implementation of general policies of the Principle 44 of the Constitution as well as those Rules enacted in terms of development plans of privatization in Iran.

Banks also are considered as one of the most important economic institutions and strong foundations for financial system of each and every economy, especially in Iran with underdeveloped and shallow financial markets. Attracting peoples' dispersed deposits, banks could supply and mobilize financial sources of Iran's economic development. Should the banks be effectiveness, allocating and flowing people dispersed deposits, they could prepare the ground for economic growth; otherwise they not only could not provide for economic development, but also would create crisis. This is why privatization of banks and contribution of private sectors in banking system of Iranian economy was deemed as a solution towards improvement of effectiveness of banks' performance in Iran's economy. The question is: "if governmental enterprises are necessarily ineffective, shall we conclude for private enterprises to be necessarily effective, and if governmental enterprises should be deserted, shall we take refuge in private enterprises, instead?"

LITERATURE

A special issue of the Journal of Banking and Finance (2005) on bank privatization and a new book by Megginson (2005a, 2005b) shed light on several empirical works on bank privatization. Among these papers, Megginson in his survey paper (2005a) and book (2005b) concludes that although privatization generally improves the performance of financial firms, the improvement is less than that observed in the studies of non-financial firms. Also the author finds that foreign ownership involvement produces a positive impact on bank performance.

According to the literature on privatization, the privatization of the firms is effective. The degree to which something is successful in producing a desired result; success. Effectiveness is the capability of producing a desired result. When something is deemed effective, it means it has an intended or expected outcome, or produces a deep.

Meyendorff and Snyder (1997) examine the transactional structures of privatization in three monobanks from Central Europe and Russia. They find that these governments are not working seriously toward breaking up the socialistic monobank system as the states in this region still control monobanks. The paper argues that various transactional structures could have significant effects on a bank's microstructure, strategy, and post-privatization performance. In another study, Unal and Navarro (1999) thoroughly examine the technical process of bank privatization in Mexico and provide a detailed explanation of this process. They argue that the lack of a previously enhanced legal and regulatory framework is a major

obstacle in the full achievement of bank privatization objectives set by the government, so there is a need to build a better regulatory and supervisory environment long before the privatization process starts.

Wachtel (1999), Hasan and Marton (2003), and Bonin, Hasan, and Wachtel (2005a) provide evidence that bank privatization is difficult to achieve in transition economies. However, the latter two papers along with another paper by the same authors, Bonin, Hasan, and Wachtel (2005b) indicate that banks with a greater foreign ownership involvement are associated with a higher effectiveness. These facts provide strong evidence that ownership structure really matters in banking. The private banks in these studies are found to be more performance than their state-owned-counterparts, and the gap increases when private banks are controlled by foreign ownership.

Shaban & Jame (2017) investigates the effects of ownership change on the performance and exposure to risk of 60 Indonesian commercial banks over the period 2005–2012. We find that state-owned banks tend to be less profitable and more exposed to risk than private and foreign banks. Domestic investors tend to select the best performers for acquisition. Domestic acquisition is generally associated with a decrease in the effectiveness of the acquired banks. Non-regional foreign acquisition is associated with a reduction in risk exposure. Acquisition by regional foreign investors is associated with performance gains

Bank Output-Input

In any economic entity like bank, the nature of goals and input is defined by our expectation and description of the entity.. In this case, the goals are profit and the inputs are the value of deposits and the number of the branch and the value of loans.

Stochastic Frontier Analysis (SFA)

The former function indicates a higher potential output for any amount of input.

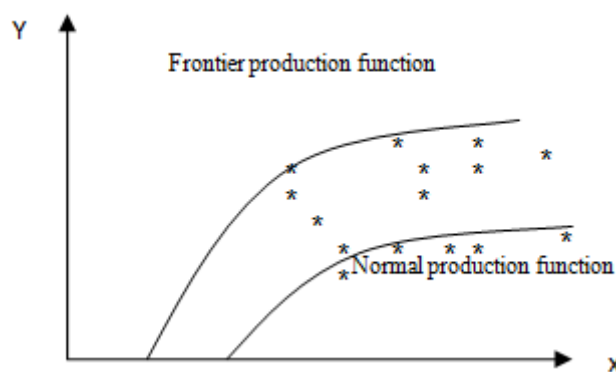


Figure 1: The Difference between Frontier and Normal Production Functions

By this method, consistent Frontier function is achieved. To estimate production function, a maximum optimization is the common approach to measuring the economy because production functions are mainly nonlinear and in this method the compatibility of non-linear function is preserved.

ESTIMATION

Effectiveness is estimated as follows:

Table 1: The Result the Estimation of the Bank Profit Function Parameters via Stochastic Frontier Method

Variable	Parameter	Coefficient	Standard Deviation	Statistic t
Fixed	β_0	8.38	2.1	3.902
The number of the branch(X_1)	β_1	0.66	0.13	5.076
bank's loan (X_2)	β_2	0.83	0.33	2.515
The amount of deposits(X_3)	β_3	0.83	0.15	1.767

Source: research findings

As illustrated table 2, the model is significant and the estimate parameters are reliable.

Table 2: Variable Parameters

Variable	Estimate Coefficient	Standard Deviation	Statistic t
<i>Sigma-squared</i> (σ^2)	7.55	4.55	7.64
<i>gama</i> (γ)	0.87	0.13	7.5
<i>LR test</i>	83.54	-----	-----

Source: Research findings

Analysis the Results from Model Estimation

The parameter β_1 suggests that the number of branch influences directly the bank loans as proved by the model estimation ($\beta_1 = 0.66$). Considering the statistical significance, Given that the whole range of the factors contributing to the profit initiatives remain invariable; a one – percent increase in the number of branch brings about an average 0.66 % increase in the profit.

The parameter β_2 is indicative of the effect bank's loan has on its profit. Based on the estimation model, given the fixed range of the fixed range of the parameters impacting on the loans, the above effect will be direct; given the invariability of all the driving forces for the loans, a 1% increase in bank's loan will increase, on the average, profit 0.83 %.

$\beta_3 = 0.83$, Considering the statistical significance, Given the invariability of the main factors driving the profit will be increased by 0.83 percent through a one- percent increase in bank's The amount of deposits as evident Table 3 , the banks average effectiveness has decreased over the time.

Table 3: The Average Bank Effectiveness for Both Public and Privatized Banks based on SFA Method

Average Effectiveness		
After Privization	Before Privization	A Merger between These Branches
0.471	0.532	0.520

CONCLUSIONS

Despite the belief shred by economists that public enterprises are necessarily ineffective and private enterprises are unavoidably effective.

In this case study, demonstrated that privatized enterprises are not necessarily effectiveness compare to those in the public sphere. Perhaps, does not transfer the management of banks (despite their privatization) and thus the problem is caused by information asymmetry and lack of supervision.

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